# MOODY'S ASSIGNS Aa3 RATING TO STATE OF CALIFORNIA GO BONDS & REFUNDING BONDS

NEW YORK, Feb 22, 1999 -- Moody's has assigned a rating of Aa3 to the general obligation bonds of the State of California. The rating reflects the state's deep and diverse economic base, its improved credit condition, including the rebuilding of cash and budget reserves, and long-term structural budget condition, even under assumptions of slowing economic growth. The credit outlook is stable.

The state's Aa3 rating is the product of its robust economy, offset by a financial condition that shows dramatic improvement, but still lags that of most states. The rating is based on the following credit considerations.

STATE ECONOMIC GROWTH PROJECTED TO CONTINUE TO OUTPACE NATION

The California economy has fully recovered from the recession of the early 1990's, and has outpaced the U.S. over the last several years in terms of employment and personal income growth. However, growth has begun to slow, reflecting the adverse effects of the Asian recession on high tech manufacturing and related industries. While the economy's increased diversification has positioned it for further expansion, the growth will likely be at a slower pace than that of the last several years. Still, Moody's anticipates the state will continue to outperform the nation over the next two years.

IMPROVED CASH POSITION PROVIDES BUFFER AGAINST REVENUE VOLATILITY

General fund balance sheet deficits accumulated during the recession have been substantially reversed and liquidity has been restored, providing a buffer against revenue volatility, a product of the state's economically sensitive tax structure. The current financial condition is sufficiently resilient to weather a mild national recession without undue stress, but a harsh or regionally concentrated state recession \'97 while considered unlikely \'97 would produce a cash crunch.

PROPOSITION 1A LIKELY TO WEAKEN DEBT POSITION

The state's debt position is moderate though slowly increasing as the state addresses its infrastructure needs. Currently, debt service represents approximately 4.4% of general fund revenues, which is less than the 6% cap recommended by the State Treasurer in its annual debt affordability report submitted annually to the governor and state legislature. Proposition 1A, the $9.2 billion initiative to fund much-needed investments in the state's school building stock, was approved by voters in the most recent general election. Future borrowings pursuant to this program, and other capital initiatives funded through debt by the state could weaken the state's debt position if the aforementioned debt affordability recommendations are not adhered to.

FY 2000 BUDGET PROPOSAL LOWERS REVENUE FORECAST

Governor Gray Davis' inaugural budget submission to the legislature does not include any major new budget policy recommendations, but assumes tax revenue collections in fiscal 1999 will be approximately $700 million lower than originally anticipated. As a result, it is highly unlikely the second phase of the MVLF reduction will be implemented. However, national economic data released just after the governor submitted his budget proposal revealed better than expected strength of the national economy and may result in greater tax revenues for the state. Moody's does not anticipate that much of such revenue will be devoted to the replenishment of reserves to earlier targets.

**OUTLOOK:**

The rating outlook for the state is stable. The economy is projected to continue to grow, but at a slower rate, as a result of above-average exposure to international economic conditions and capacity constraints in the high technology sector. General Fund reserves will decline in fiscal 2000 if projected revenue shortfalls are not addressed through offsetting expense reductions. Given the scale of capital needs, the debt burden is likely to grow, but a new annual debt affordability process may constrain that growth somewhat.

**DEBT AFFECTED:**

| ISSUE | | RATING |
|---|---|---|
| General Obligation Bonds and Refunding Bonds | | Aa3 |
| **Sale Amount** | $500,000,000.00 | |
| **Expected Sale Date** | 02/23/99 | |
| **Rating Description** | General Obligation Bonds and Refunding Bonds | |

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